Report of the Western Finance Ministers

Economic and Fiscal Developments and Federal-Provincial Fiscal Relations in Canada

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Mandate from Western Premiers

At their meeting in Portage la Prairie, Manitoba, in May 1990, Western Premiers expressed concern about a number of economic and fiscal developments in Canada. They requested their Finance Ministers and Treasurers to form a task force to look at these issues in more detail and to work closely with Ottawa and the other provinces to address the critical economic problems facing the country.

In conjunction with this initiative, the Ministers were asked to prepare a detailed report on:

- recent trends in federal-provincial fiscal relations, including federal cutbacks and offloading;
- the foundation necessary for an appropriate federal-provincial fiscal structure; and
- a process for furthering this review with other provinces and the federal government, beginning with the 1990 Annual Premiers' Conference in August and this year's First Ministers' Conference on the Economy.

This paper has been prepared by the Western Finance Ministers' Task Force in response to this mandate from the Premiers.

Introduction

Critical economic and fiscal issues face the country. The most important factors affecting the country's medium- and long-term prospects are budget deficits and the rapidly growing public debt. Deficits reflect a major problem with Canada's public finances: spending levels have risen beyond the capability of existing revenues to sustain them.

The federal annual deficit, which is projected to total $28.5 billion by the end of the current fiscal year, is the most prominent of government deficits. Federal debt will grow to $380 billion this fiscal year. Attempts at controlling it are being thwarted by slower growth in the national economy, the further rise in interest rates and the loss of competitiveness in the Canadian economy, which has squeezed profit margins, limited employment growth and constrained growth in government revenues. Because interest costs are absorbing over 35 cents of every federal revenue dollar, the federal budget has become "hostage" to the public debt. The amount of services people receive per dollar of tax paid is being steadily reduced.

At the provincial government level substantial deficits totalling more than $4 billion annually are still being incurred.

How the Debt and Deficit Problem Developed

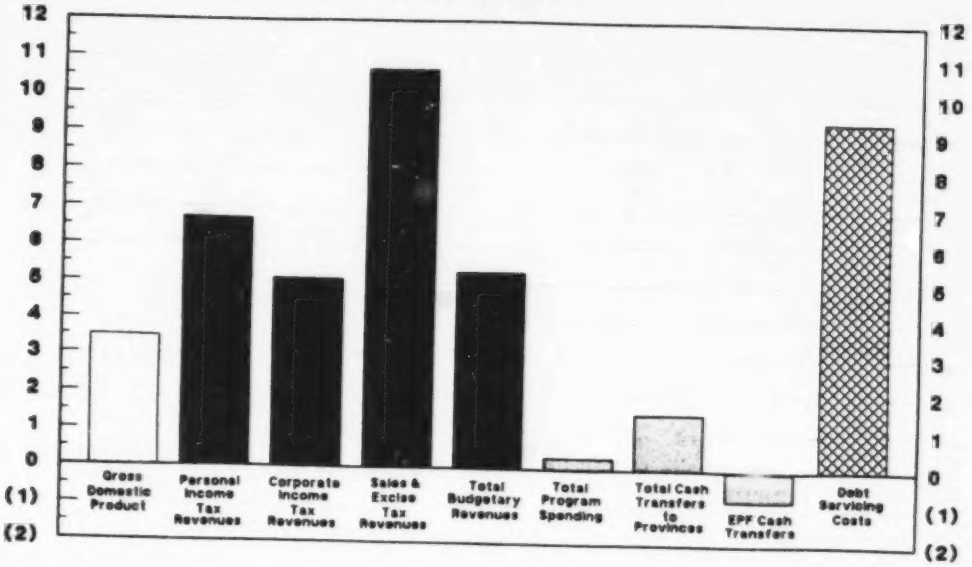
Total federal and provincial deficits in Canada increased sharply in 1982/83 as a result of the recession. Revenue growth slowed and expenditures continued to grow rapidly. The federal deficit rose from 25 per cent of revenue to over 45 per cent, while provincial deficits increased by seven percentage points, to about 16 per cent of revenue. By 1984/85, a burgeoning federal deficit had reached 54 per cent of revenue.

Since 1984, the federal deficit measured as a proportion of revenue has declined to about 24 per cent (1990/91). This has been largely accomplished through tax increases and strong economic growth, which has boosted real growth in total budgetary revenue by over 5 per cent annually. Deficit reduction has also been assisted by some efforts to hold program spending at close to the level of inflation, and through significant reductions in planned transfers to the provinces.

Federal Fiscal Indicators

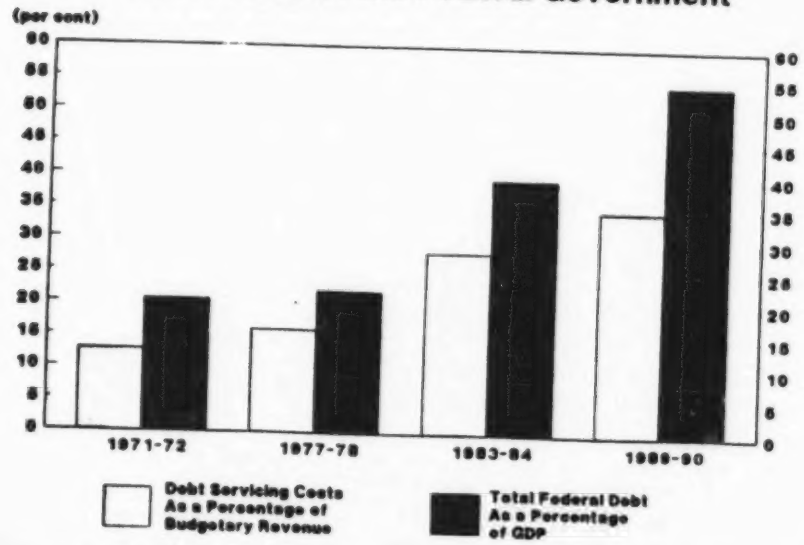
Real Annual Growth Rates (per cent)

1983/84 to 1989/90



Nevertheless, Canada still has the second highest deficit to Gross Domestic Product (GDP) ratio of any of the G-7 countries. Moreover, persi ent deficits are requiring an increasing proportion of revenue to service debt. Federal debt charges, which amounted to about 12 per cent of revenue in 1971/72, have climbed sharply to 35 per cent. In 1990/91, interest payments are expected to total $41.2 billion. This trend cannot be allowed to continue.

Debt Profile of the Federal Government



Impact of Federal Economic and Fiscal Policies

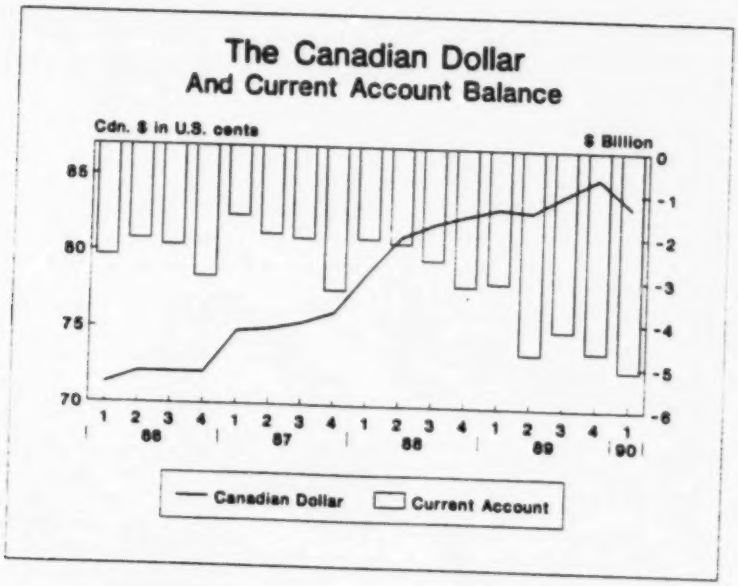
Federal economic and fiscal policies are having an adverse impact on the Western provinces.

Interest and Exchange Rates

The combination of the Bank of Canada's anti-inflation monetary policy and the need to finance the federal deficit has resulted in:

- historically high real interest rates;
- an abnormally wide gap of almost 6 percentage points between Canadian and U.S. short term interest rates; and
- a currency value which is too high.

Large and persistent deficits have resulted in government appropriating a large share of national savings. This pushes up interest rates, crowds out private investment and, when combined with an overvalued currency, may cause deterioration in the country's current account balance.



Current account deficits result in growing foreign indebtedness and a subsequent outflow of interest payments. High interest rates discourage investment, affecting especially capital-intensive economies with high unit labour costs like Canada's. Maintaining and improving our high standard of living in the face of increasing competition from countries with much lower labour costs requires a persistently high level of capital investment embodying the latest technology.

Many Canadian industries, notably agriculture, have high levels of debt. Most of the Canadian business sector took advantage of strong profitability and favourable equity markets in the 1980s to improve balance sheets. However, the debt/equity ratio rose in the latter part of 1989, leaving many businesses once again more vulnerable to rising interest rates.

Rising short-term interest rates are affecting interest-rate-sensitive areas of consumer demand, such as new housing and automobiles. With a very large part of household debt contracted at short-term floating rates, consumers are also vulnerable.

High interest rates also increase government debt servicing costs. A one percentage point rise in rates increases the federal deficit by $1.7 billion in the first year, rising to $3.5 billion by the fourth year.

Another consequence of deficits and debt was outlined by the federal Minister of Finance in his 1990 Budget speech:

> *"A public debt growing faster than national income does more than feed on itself. It consumes more and more of the dollars we need to maintain existing programs, meet new priorities and keep taxes down. Ultimately, it consumes the hope and the opportunity that should be the legacy we pass on to our children. Instead, a runaway debt becomes our legacy".*

A recession could cause the deficit to worsen markedly because revenue growth would decline. With a weak economy, it would be very difficult to increase taxes to make up for lost revenue. Neither would counter-cyclical fiscal policy (i.e. stimulating the economy

with more government spending or tax cuts) be an option for a debt-ridden government. Debt and debt-service costs would escalate as they had in the 1980s.

International Competitiveness

In an open economy such as Canada's, where nearly one-third of our GDP is in exports, it is crucial to maintain the competitiveness of our products. Any increase in the price of our products can lead to a loss of market share for Canadian goods in both the export and domestic markets.

By holding the value of the Canadian dollar higher than it would otherwise be, high interest rates have made it more difficult for businesses to take advantage of the Canada-U.S. Free Trade Agreement. The Western Provinces, with a higher proportion of export-oriented resource industries, are most seriously affected by high exchange rates, since these industries must accept U.S. dollar prices for their products while paying Canadian dollars for domestic inputs, particularly labour.

Productivity of capital can be improved through research and development and capital investment in superior technology. Such investment is at risk because of high interest rates.

Labour productivity is largely determined by the equipment, technology and training available to workers. The attitude of employees to their work and the incentives provided to them for increased productivity are also key factors.

During the late 1980s, compensation accelerated while Canadian labour productivity growth (growth in output per worker) slowed. The combination of these two factors has made Canadian goods less competitive abroad and our producers less profitable. There was a 6 per cent increase in unit labour costs in manufacturing between 1987 and 1989, measured in Canadian dollars. This compares to a rise of 2 per cent in the U.S. and a decline of 2 per cent in Japan. When exchange rate movements are taken into account, the differences are even larger: unit labour costs rose by 15 per cent in Canada while they declined by 8 per cent in the U.S. and 6 per cent in Japan.

A depreciation of the Canadian dollar could lead to some recovery of our competitive position in the near term. In the longer run, however, the competitiveness of our goods and services depends on both the productivity and the cost of the capital and labour used.

Wage gains were also apparent in the public sector. Increases in wages in the health and education sectors have raised average provincial wage settlements. Nevertheless, in seven of the provinces, including all Western Provinces, compound annual wage increases over the last 6 years for government employees have been below increases for federal government employees.

There are two main conclusions from this analysis.

1. The Bank of Canada and the federal government must recognize the potentially negative impact of monetary and fiscal policies on investment, which determines the future ability of the economy to supply goods and services.

2. Both the federal and provincial governments must ensure that public sector wage settlements are affordable for taxpayers, and do not create undue pressure for uncompetitive settlements in the private sector.

Agriculture

The Canadian agriculture industry continues to be plagued with problems of high farm debt and volatile commodity prices. These problems have been particularly serious for prairie producers. In 1990, Western Canada farm cash receipts are forecast to decline by 8 per cent, net cash income by 39 per cent, and realized net income by 71 per cent from the 1985-89 five-year average. The declines arise primarily from a forecast 58 per cent fall in net cash income for the western grain sector due to expectations that grain prices will be weak, and that no payments will be made under the Western Grain Stabilization or Special Canadian Grain Programs. Saskatchewan, with its high proportion of grain to livestock production, has been particularly hard hit.

Two to three years of localized, successive droughts in the Prairie Provinces exacerbated the serious debt problems of some farmers. Over the longer run, agricultural problems must also be attributable to the existence of low operating margins.

Western Finance Ministers agree that GATT negotiations must be focused on ways to reduce international trade barriers and lower the market-distorting agricultural subsidies that currently put Canadian producers at a disadvantage vis-a-vis their heavily subsidized competitors.

Recent Changes in the Federal-Provincial Fiscal Relationship

Federal Offloading

Earlier this paper outlined some of the consequences of Canadian economic mismanagement. High interest rates, reduced competitiveness and fiscal imbalances are threatening our nation's future.

Western Finance Ministers are of the view that part of the government deficit problem in Canada reflects an evolution of fiscal federalism. The separation of taxing and spending decisions has eroded constraints on government in meeting demands for publicly-provided goods or services. No one order of government remains clearly accountable to the taxpayer. Competition between orders of government to meet perceived public demands can create a permanent upward bias in government spending.

The federal government purports to have tackled the problem through expenditure restraint. However, it is quite clear that much of the expenditure restraint at the federal level, and in particular the expenditure restraint within the 1990 federal Budget, was achieved through cuts in federal-provincial transfer payments. Shifting the deficit from one order of government to another does not change the overall public sector deficit, nor remove the financial and monetary straight-jacket into which we have now been forced.

Increasingly over the past few years, federal government efforts at deficit reduction have had the effect of transferring fiscal responsibilities onto the provincial governments. The increase in provincial fiscal responsibilities has three main root causes:

1. elimination or reductions of federal commitments to joint federal-provincial programs ("reductions");
2. withdrawal of federal funding from programs in areas where the provinces then become the service provider or where the provinces must respond to resulting economic hardship ("withdrawals"); and
3. demands for provincial funding in program areas previously fully funded by the federal government ("cost-sharing demands").

An examination of the record shows that federal offloading began in earnest in 1982 and continued throughout the decade. The 1990 federal Budget unfairly singled out provinces and achieved 37 per cent of federal expenditure reductions in 1990/91 and 57 per cent of reductions for 1991/92 from transfer payments to provinces.

Federal Efforts Prior to 1990

Reductions -- Examples of increased provincial fiscal responsibilities due to the first root cause (reductions) include:

- **Established Programs Financing (EPF)** -- As originally negotiated by federal-provincial agreement, EPF transfers to the provinces for support of health care and post-secondary education increased at the rate of growth in the national economy.
  - In 1982, the Revenue Guarantee portion of EPF was unilaterally eliminated by the federal government.
  - In 1984/85 and 1985/86, the federal government held the rate of growth in the "post-secondary education" portion of EPF to 6 per cent and 5 per cent, respectively.
  - Beginning in 1986/87, the federal government restricted the rate of growth in EPF entitlements to a rate equal to the rate of

growth in Gross National Product (GNP) less 2 percentage points.

- In the 1989 federal Budget, the rate of growth was restricted to GNP less 3 percentage points, beginning in the 1990/91 fiscal year.

- **Economic and Regional Development Agreements (ERDAs)** -- These agreements formerly provided federal-provincial cost-sharing on major development activities such as reforestation, irrigation, recreation and tourism development and agricultural development. The sub-agreements to the main agreement expired March 31, 1989, and are only now being renegotiated at significantly reduced levels of federal support.

- **Equalization** -- In 1982, the federal Equalization program was amended to limit the rate of growth in total Equalization payments from the federal government to the recipient provinces to the rate of growth in GNP. The ceiling as a percentage of GNP was lowered in 1987. This ceiling became effective in 1989/90 when recalculation of Equalization revealed that entitlements had grown in excess of GNP in both 1988/89 and 1989/90. Provincial losses over the three years to 1990/91 will amount to approximately $1.6 billion.

Withdrawals -- Examples of increased provincial responsibilities due to the second root cause (withdrawals) include:

- **Services to Treaty Indians** -- The federal government has intensified the process of reducing services to Treaty Indians in several areas, including:
  - social assistance payments to off-reserve Treaty Indians;
  - education for off-reserve Treaty Indian children and post-secondary education for all Treaty Indians; and
  - health care services for Treaty Indians.

- **Young Offenders Program** -- The federal Young Offenders Act came into effect in 1984. This new Act placed many demands on provincial government expenditures. These demands were partially offset by a funding agreement with the federal government. This agreement expired March 31, 1989 and has not been replaced. Federal funding for Young Offenders has been frozen at the 1989/90 levels.

- **Unemployment Insurance** -- The federal government has attempted to make several changes to the U.I. Program, most of which reduce program coverage. Reduced program coverage results in increasing pressure on provincial government expenditures for social assistance and other services.

- **Military Expenditures** -- In the 1989 federal Budget, Canadian Forces Bases were scheduled to be closed at Summerside, Prince Edward Island, at Winnipeg's Kapyong Barracks and at Portage la Prairie, Manitoba causing considerable local economic hardship and forcing provincial government responses.

Cost-Sharing Demands -- An example of increased provincial costs due to the third root cause (cost-sharing demands) is:

- **Crop Insurance/Agricultural Assistance** -- The federal government has historically provided all the government portion of crop insurance premiums (50 per cent of total premiums), while the costs of administration were borne by the provinces. In 1989, the federal government moved to force the provinces to accept responsibility for 50 per cent of the government portion of premium costs, while accepting federal responsibility for 50 per cent of the significantly lower costs of administration.

  At the same time, provinces are being asked to contribute significantly to the costs of federal programs for drought relief and emergency agricultural assistance.

The 1990 Federal Budget

The February 1990 federal Budget further increased federal offloading, in particular with respect to federal transfers. Transfer cuts were major and made unilaterally by the federal government without consultation or notice to provinces. Significant cost increases to provinces are projected as a result of reductions in federal transfer payments programs:

- **Established Programs Financing (EPF)** -- EPF transfers to the provinces for support of health care and post-secondary education were frozen at their 1989/90 levels for the next two fiscal years.

  EPF transfers consist of two components, a transfer of income tax room provided in 1977 when federal taxes were reduced to allow provinces to raise their taxes, and a residual cash payment. With total transfers frozen, the rising value of tax points transferred will result in reductions in the amount of the federal cash payments to the provinces in both 1990/91 and 1991/92.

The effect of the 1990 EPF reductions will be as follows:

	Western Provinces' Losses	All Provinces' Losses
	(millions of dollars)	
1990/91	253	869
1991/92	453	1,541

Combined with earlier reductions, the total effect of the EPF reductions will be as follows:

	Western Provinces' Losses	All Provinces' Losses
	(millions of dollars)	
1990/91	1,553	3,127
1991/92	2,028	4,597

- **Canada Assistance Plan (CAP)** -- The federal government has attempted to limit payments under CAP, federal cost-sharing for provincial welfare and social assistance programs, to 5 per cent growth in each of the next two years for provinces that do not receive federal Equalization payments. The affected provinces are British Columbia, Alberta and Ontario.

  British Columbia launched a court action claiming that the federal reductions were in contravention of the Canada Assistance Plan agreements. Alberta, Manitoba and Ontario intervened in this court action. The B.C. Court of Appeal ruled on June 15th that the federal government could not unilaterally breach the CAP agreements. The federal government has announced it will appeal this decision to the Supreme Court of Canada.

The restrictions to the rate of increase in CAP funding will, if implemented, save $75 million in 1990/91 and $80 million in 1991/92, according to federal estimates. Ontario estimates that their losses alone will considerably exceed these amounts.

Impact on the Western Provinces

An exhaustive list of federal offloading efforts is currently unavailable. However, the cumulative impact of major federal offloading measures from 1982/83 through 1992/93 on the four Western Provinces is as follows:

Impact of Federal Offloading on the Four Western Provinces

(millions of dollars)

	1989/90	1990/91	1991/92	3-Year Total
Established Programs Financing	1,033.7	1,552.9	2,028.4	4,615.0
Equalization	220.2	106.4	155.0	481.6
Agricultural Programs	27.9	228.4	192.2	448.5
Other Programs	195.1	314.6	360.8	870.8
Total Impact	**1,476.9**	**2,202.3**	**2,736.4**	**6,415.6**

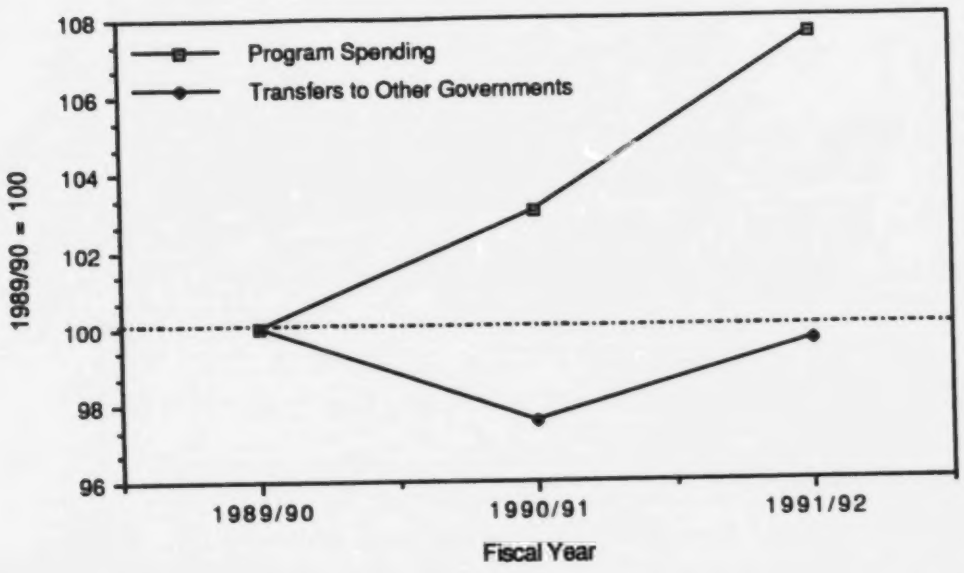
As a result of federal measures implemented since 1982/83, the four Western Provinces have experienced a combined fiscal impact from federal offloading of $2.2 billion in 1990/91, an amount which could grow by 24.3 per cent to $2.7 billion by 1991/92 (see Appendix).

Offloading as a Federal Fiscal Measure

The federal Minister of Finance has asked the provinces to do their part to reduce the federal deficit. But, it appears the provinces have done more than their fair share. From 1986/87 through 1991/92, federal program spending, net of transfers to other

governments, will have grown 25.8 per cent -- an average growth of 4.7 per cent per year. Over the same period, transfers to other governments (largely the provinces) will have grown at an average rate of only 3.4 per cent per year. In fact, cash transfers to other governments in 1991/92 will be 0.7 per cent lower than they were in 1989/90, while the federal government's program spending net of these transfers will be 10.0 per cent higher than the 1989/90 level.

Federal Program Spending and Transfers to Other Levels of Government



Reductions in payments to the provinces have outstripped the federal government's efforts to control its own internal spending. Given that reductions in transfers to other governments are of no net benefit in reducing government deficits borne by Canadian taxpayers, the recent federal government efforts to reduce the deficit through transfer reductions instead of reducing internal government spending fall far short of addressing the problems of Canadian fiscal balances.

Cancelled Commitments

In addition to forcing the federal government to employ the offloading strategy, the deficit resulting from large debt-servicing costs is crowding out federal expenditures in several important areas where federal commitments had already been made. Examples include:

- a decision not to proceed with federal assistance for the Other Six Lease Operations (OSLO) oil sands project in Northeastern Alberta at a total federal savings of $650 million, potentially causing the cancellation of the project;
- elimination of the Polar 8 Icebreaker Project, which was originally offered as compensation for the loss of the frigate program, depriving the British Columbia shipbuilding industry of this $680 million project;
- reduced funding for Indian and Inuit programs, often placing the provinces in the position of replacing this funding;
- reductions in Secretary of State funding for cultural organizations and women's groups, which the provinces are being asked to replace; and
- reductions in the national social housing budget for new projects by 15 per cent in 1990 and an additional 15 per cent in 1991.

Centralization of Taxing Powers

The fiscal pressures on provincial governments, which have been amplified by federal efforts to offload expenditure responsibilities, have been exacerbated by federal measures to centralize taxing powers.

The most notable of these measures is the federal Goods and Services Tax (GST) to be introduced in January of 1991. This unilateral federal move to impose, in effect, a sales tax at the retail level, a tax base traditionally occupied solely by the provinces, occurred in the midst of discussions with the provinces on efficient tax base sharing.

The introduction of the GST will result in federal sales tax revenues increasing by $1.8 billion over the yield of existing federal sales tax in 1991/92. While this federal occupancy of tax room previously left to the provinces is difficult enough in light of increasing budgetary pressures on the provinces, the complexity added to tax systems by the layering on of the federal GST also complicates provincial tax administration.

Federal control over the income tax system, effected through tax collection agreements with most provinces, has been exercised with less than appropriate flexibility for provinces. Proposals have been put forward by provinces to address their concerns.

Principles of Intergovernmental Fiscal Arrangements

Effective fiscal relations among governments can only be ensured in the long run when such relations are founded on and consistent with a firm set of principles. Arrangements which are created without regard to solid principles will be fraught with difficulties at every turn. Arrangements built on commonly accepted principles will endure the many and unpredictable challenges of economic and social change.

While the specific attributes of fiscal arrangements may be virtually limitless in their number, a core set of operating principles for good relations can be readily identified.

Historical Principles of Fiscal Arrangements

In the past, principles have been established in a number of discussions on fiscal arrangements.

In June 1976 at the Conference of Federal and Provincial First Ministers, the Prime Minister of Canada espoused the following objectives behind the Established Programs Financing proposal:

- to maintain and improve the standards of service to the Canadian public;

- to provide greater stability to facilitate expenditure planning by both levels of government;
- to provide greater spending flexibility to the provinces;
- to increase equality in the amount of federal funding received by the provinces; and
- to provide continuing joint policy discussions.

In August 1981 the Parliamentary Task Force on Federal-Provincial Fiscal Arrangements articulated the following principles of fiscal federalism:

- fiscal arrangements should provide to both orders of government access to sufficient fiscal resources to meet constitutional responsibilities;
- each government should be accountable to its electorate for its taxing and spending decisions, and should make these decisions with due regard to the effect on other governments;
- fiscal arrangements should, through a system of equalization grants, enable each province to provide adequate levels of services at similar levels of taxation;
- there should exist uniform intergovernmental arrangements and uniform application of federal laws in all provinces; and
- the fiscal arrangements should provide a mechanism for harmonizing the policies and priorities of the two orders of government.

Operating Principles for Sound Fiscal Arrangements

The Western Finance Ministers have considered operating principles and endorse the following as the necessary foundation for the construction of fiscal arrangements in Canada.

1. An Equitable and Responsible Partnership

It is fundamental that financial arrangements match fiscal capacity to constitutional responsibility. Fiscal arrangements must recognize and

strengthen the partnership that exists between the two orders of government and among the provinces to meet the common objective of providing services. Arrangements must be equitable such that these services may be provided on a reasonably comparable basis and with reasonably comparable levels of taxation throughout Canada.

2. Adequacy/Affordability

Fiscal arrangements must be adequate to finance services and at the same time they must be affordable to each government. The balance between adequacy and affordability must be appropriate in the context of defined responsibilities and levels of services and taxation desired by the public.

3. Efficiency, Flexibility, and Responsiveness

Fiscal arrangements must allow and encourage all orders of government to provide public services efficiently and to meet (and not exceed) public demand effectively. Governments must be able to respond to the unique characteristics of their respective jurisdictions and to changing circumstances over time.

4. Stability/Predictability

Fiscal arrangements must be both stable and stabilizing. They should add stability to the economies of the federation and increase the predictability of circumstances within which governments plan and operate.

5. Simplicity/Accountability

Simplicity is a key element of fiscal arrangements. The effects of arrangements must be easily understood by governments and their constituents. Clarity of purpose and results enhance accountability of governments for taxes and the quantity and quality of programs provided with public funds.

The Record of the 1980s -- Principles Abandoned

Principles do conflict, and it must be expected that resolution of conflicts is difficult. However, in the decade of the 1980s, and particularly in the federal Budget of 1990, provinces see an abandonment of the principles underlying major federal transfer programs to provinces. The necessary balance in federal-provincial relations has been lost.

Adequacy and affordability have been considered only in relation to the federal need to reduce expenditure growth -- the dollar commitments provinces have to make to maintain costly social programs have been ignored. Flexibility, efficiency, stability and predictability, if considered at all, have been considered in federal terms. For the provinces, fiscal relations through the decade have been marred by inflexibility, inefficiency, instability and unpredictability. Accountability to the public has been destroyed in a "numbers war" between the federal and provincial governments. Lower fiscal capacity and the equalization ceiling make equalization-recipient provinces especially vulnerable to cuts in other federal programs and transfers which shift responsibilities to the provinces. In the end, the fundamental partnership among the governments in Canada has been severely damaged.

Renewing Fiscal Federalism in Canada

Accepting Responsibility

The interdependence of federal and provincial revenue and expenditure decisions makes no one government accountable for the overall results. We all bear some responsibility.

Provinces and the federal government working separately to control their individual budgets may fail because the nature of our federal-provincial system is such that actions taken at one level of government or in one jurisdiction may spill over to other governments.

The federal government recognized the need for federal-provincial co-operation in its 1984 document, *A New Direction for Canada - An Agenda for Economic Renewal*, when it said that:

> *Federal and provincial governments must...recognize that there is only "one taxpayer." We must both strive to reduce the overall burden of government on the Canadian taxpayer.*

A better way must be found to manage and control public finances in Canada co-operatively.

Meeting the Economic Challenge

With the Canada-U.S. Free Trade Agreement in place, full European economic integration approaching, new competitors emerging in the Pacific Rim and economic reform occurring in Eastern Europe and the Soviet Union, Canada faces many challenges but also has many opportunities.

It is essential that we increase our competitiveness in the global marketplace. To do this, we must invest. But, we cannot invest if deficits continue to use up domestic and foreign savings.

And, there is little room for tax increases to reduce deficits if we are to retain our tax competitiveness with other G-7 countries, particularly the United States and Japan, our major trading partners. Government revenues equal about 40 per cent of Gross Domestic Product in Canada, compared to 32 per cent in the United States and 33 per cent in Japan. Government expenditure in Canada equals 46 per cent of Gross Domestic Product as compared to 37 per cent in the United States and only 33 per cent in Japan.

Meeting the Fiscal Challenge: The Control and Management of Public Finances in Canada

While some progress has been made in narrowing the gap between revenue and expenditure in Canada, much more must be done to reduce the federal deficit, and it is time to act.

Because we are failing to meet the fiscal challenge, it is time to explore avenues for greater co-operation including:

- examining federal and provincial spending in areas of shared or overlapping jurisdiction and rationalizing programs and responsibilities;
- examining other areas of spending by the federal government that have spillover effects on provincial governments and reducing such spillovers; and
- examining the impact of the federal government's practice of setting program standards in areas of provincial jurisdiction on the ability of provincial governments to manage expenditures.

The feasibility and desirability of instituting legislated fiscal controls at the federal level, similar to the discipline now imposed on the U.S. Administration, could also be examined.

Renewing Federal-Provincial Fiscal Arrangements

The "status quo" option, which allows unilateral federal action on fiscal arrangements, is not acceptable to the Western Provinces.

Adhering to accepted principles of fiscal federalism, including the principle of equalization enshrined in the Constitution, the interests of both orders of government must be recognized and balanced as negotiations proceed on existing and new arrangements. A broad range of options could be considered. Binding federal-provincial agreements could be negotiated. There are many areas in which disentanglement of federal and provincial

jurisdiction could be pursued in order to enhance efficiency and accountability with respect to both expenditure and revenue aspects of government.

A Process for Reform

For most Ministerial responsibilities, ongoing processes are in place which assure periodic meetings of provincial Ministers separate and apart from the federal-provincial forum. These meetings provide opportunities to discuss matters of common concern and to share provincial perspectives on the issues and possible solutions. Among more developed forums are the Council of Ministers of Education, the annual Conferences of Provincial Health Ministers, Provincial Environment Ministers with a permanent Secretariat, and Trade Ministers.

Finance Ministers are an exception to this general practice. Provincial Finance Ministers rarely meet independently of the federal-provincial forum. As a result, provinces can oftentimes be less informed than the federal government about issues in other provinces which have inter-provincial implications. Opportunities to consider issues of more exclusive provincial concern are lost.

In this mode, the federal government sets the agenda and pace for discussions. Furthermore, Ottawa has often taken advantage of its more intimate knowledge of individual provincial concerns to underscore differences in views among provinces as justification for unilateral federal decision-making.

In some provinces, the federal approach has succeeded in breaking down effective central co-ordination of federal-provincial negotiations into smaller segmented units and pushing through more favourable terms for any federal contributions.

The earlier sections of this paper outlined the consequences of our past and present efforts on debt and deficits, interest rates, investment and economic competitiveness. The federal government response of cutbacks and offloading affecting provincial governments is a sombre record. Western Provincial Finance Ministers are interested in attempting to change

that record by taking greater initiative and setting the agenda for pursuit of agreed upon goals with respect to fiscal federalism.

Specific proposals include:

- regular Western Finance Ministers' meetings to develop and pursue reform initiatives;
- meaningful pre-budget consultation meetings amongst all provincial Finance Ministers, and with their federal counterpart, to develop co-operative fiscal strategies and directed toward an attack on fiscal imbalances in Canada;
- during the ongoing review of federal-provincial fiscal arrangements, consideration of various expenditure and revenue options with respect to financing major programs within provincial jurisdiction; and
- improving public consultation and accountability of government to Canadians concerning fiscal issues.

Conclusion

Western Finance Ministers believe new answers are required. They have a clear direction, ideas they want to explore more completely, an openness to new proposals on better ways to manage government expenditure and fiscal relations in Canada, and a willingness to work together to meet the challenges that they see Canada facing in the years ahead. They wish to invite their colleagues in other provinces and the federal Finance Minister to join them in this process aimed at renewing fiscal federalism in Canada.

Towards Renewal: Options for Consideration

Western provincial Finance Ministers propose four options which, in consultation with the public, warrant consideration in moving toward renewal of fiscal federalism in Canada.

Disentanglement: a fundamental re-examination of federal and provincial spending responsibilities and revenue capacity. This would be aimed at reducing federal spending in areas of provincial responsibility with accompanying transfer of adequate fully equalized tax room.

Income Tax Collection: an independent Western Canadian income tax administration to assure reasonable flexibility in provincial tax structures to respond to provincial economic and social priorities.

Limits to Spending: legislative and other means to control spending and taxing by all governments working towards elimination of deficits and a reversal of the escalating debt burden which is threatening our ability to maintain vital programs.

Reformed Policy Coordination: means of fostering more effective coordination of policy and initiatives among provinces and between provinces and the federal government in order to facilitate effective provincial contribution to decision making in key national policy areas, including monetary policy and planning for fiscal policy.

Appendix

Detailed Breakdown of the Impact of Federal Offloading on the Four Western Provinces

(millions of dollars)

	1989/90	1990/91	1991/92
Established Programs Financing			
* Revenue Guarantee	480.3	522.5	559.7
* 6/5 % on PSE	104.7	114.7	122.0
* GNP - 2	448.7	628.4	823.1
* GNP - 3	–	34.6	70.8
* Growth = 0	–	252.7	452.8
Equalization Ceiling			
* 1990/91 Entitlement	–	106.4	15.0
* Other Years' Entitlements	220.2	–	140.0
Agricultural Programs			
* Crop Insurance	4.9	115.7	120.7
* Drought Relief/Emergency Agricultural Assistance	23.0	112.7	71.5
Other Programs			
* Manpower Agreements	66.2	69.2	71.2
* ERDAs	100.6	145.0	146.0
* CAP Restriction	–	9.0	24.6
* Treaty Indians	5.0	31.0	44.0
* Miscellaneous	23.3	60.4	75.0
Total Impact	**1,476.9**	**2,202.3**	**2,736.4**